HUNTON & WILLIAMS

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Contents

A $400 Million Devil in the Details: The Cautionary Tale of the Chesapeake Par Call

In February 2012, Chesapeake Energy Corporation issued $1.3 billion in 10-year senior notes. The notes contained a standard make-whole provision.[1] The notes also contained a very unusual optional redemption feature allowing Chesapeake to call the notes for approximately one year after issuance (the "early par call"). The early par call allowed Chesapeake to repay the notes at par, in other words, *without* paying a make-whole premium. If the early par call deadline passed, however, Chesapeake would have to rely on the standard make-whole redemption provision.

Interest rates fell dramatically after the notes offering. Accordingly, Chesapeake took steps to utilize the early par call. On March 15, 2013, Chesapeake issued a notice to redeem the notes at par plus interest to the scheduled redemption date, May 14, 2013. Chesapeake's view was that under the indenture it had until March 15, 2013, to give notice to noteholders that it was calling the notes (and not pay the make-whole premium). The trustee, on behalf of certain noteholders, argued that in order to avail itself of the early par call, Chesapeake was supposed to *complete* the redemption by March 15, 2013. If the notes were not so redeemed, Chesapeake would have had to pay the present value of all the interest due over the notes' life (computed using a discount rate set forth in the make-whole redemption calculation), a $400 million cost.

After discussions broke down between Chesapeake and the trustee over the proper interpretation of the notice provisions of the indenture, litigation ensued. As Judge Paul Engelmayer of the Southern District of New York noted in his opinion on this case, "Lots of money turns on this dispute."

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1 A call provision allowing the issuer to pay off the remaining debt early. The issuer has to make a lump-sum payment derived from a formula based on the net present value of future coupon payments that will not be paid because of the redemption.

The Deal

On the evening of Thursday, February 9, 2012, Chesapeake contacted its attorneys to begin work on the deal. The same evening the lead investment bank on the notes offering (the "lead bookrunner") contacted underwriters' counsel to inform them of Chesapeake's and the lead bookrunner's intentions. Late Friday evening, a first draft of the prospectus supplement was sent out by issuer's counsel stating that during the early redemption period — November 15, 2012, until March 31, 2013 — the notes would be redeemable at a price equal to 100 percent plus interest. Over the weekend, Chesapeake, the lead bookrunner and their counsel negotiated the concept and mechanics of the early par call. By Sunday night, there was consensus among the parties as to the business deal: i.e., to make the period of November 15, 2012, through March 15, 2013, the time frame within which Chesapeake merely had to give notice that it planned to exercise its call option (as opposed to the time frame within which a redemption would actually have to be completed). When the transaction launched on Monday morning February 13, the prospectus stated that "[w]e may redeem the notes pursuant to the special early redemption provisions so long as the notice of redemption is given during the Early Redemption Period." The "Early Redemption Period" was defined as any time from and including November 15, 2012, to and including March 15, 2013.

The deal successfully launched and priced on Monday February 13. In preparation for closing, counsel drafted a supplemental indenture containing the terms of the notes and incorporating certain mechanical redemption provisions from the base indenture. The dispute between Chesapeake and the noteholders centers squarely on the interplay between the disclosure, the redemption provisions in the supplemental indenture and the seemingly inconsistent redemption provisions in the base indenture. Without getting into the legal bases of the conflicting indenture interpretations,[2] the trustee on behalf of certain noteholders argued that the redemption notice provisions in the base indenture control. Specifically, the trustee argued that Chesapeake was required to give noteholders at least 30 days' notice prior to redeeming the notes and thus, in order to redeem the notes in the Early Redemption Period, Chesapeake was required under the base indenture to give notice by February 13, 2013 (which was 30 days before March 15, 2013).

The Decision

After a three-day trial, Judge Engelmayer ruled that Chesapeake was allowed to redeem the notes without paying the make-whole premium because it had provided notice to noteholders by the March 15 deadline. The court reiterated that "[i]nterpretation of indenture provisions is a matter of basic contract law."[3] The court in interpreting a contract looks to give effect to the intent of the parties as revealed by the language of their agreement.[4] Judge Engelmayer admitted that the indenture provision at issue was "clumsily drafted," but determined that it was subject to only one reasonable interpretation and was not ambiguous. The trustee filed notice of its appeal on May 11, which will be heard by the US Court of Appeals for the Second Circuit.

Lessons Learned

It is not often that a senior notes issuance by an investment grade issuer results in a $400 million litigation. This case, however, serves as a reminder for the unwary.

Despite sophisticated legal counsel for all the parties in the transaction, it is clear that everyone involved would have preferred that both the disclosure and the operative documents had been more clear on this point. One takeaway is that each set of counsel (including, in a perfect world, trustee's counsel) should be brought in as early as possible in the process, should be cognizant of the "business deal" among the principals and should draft and review disclosure in that light.

But issuers and bankers should take heed also of the risk of a transaction taken to market too quickly. We are all too aware that markets can turn in a matter of hours, much less days. As described in the decision in Chesapeake, the working group was notified on a Thursday afternoon about a notes offering with a Monday morning launch. For cookie-cutter debt capital markets transactions with sophisticated counsel, this may be ample time. If novel structural or diligence issues arise, such a timeline comes with risk.

[2] For legal practitioners in the debt capital markets, Judge Engelmayer's opinion is a gold mine for a discussion of the legal underpinnings of indenture interpretation under New York law.

[3] *Chesapeake Energy Corporation v. The Bank of New York Mellon Trust Company, N.A.*, 13 civ.1582, at 14.

[4] *Id.* at 15.

A Wrap for the Canadian Wrap?

On April 23, 2013, the Ontario Securities Commission (OSC) granted exemptive relief through an order (the Order)[5], which will permit certain foreign securities dealers[6] to privately place foreign securities in Canada without the need for supplemental Canadian disclosure, typically referred to as a Canadian wrapper. Although the exemption has been granted by the OSC, the relief will be available to issuers selling in all Canadian provinces and territories. The exemption went into effect on June 22, 2013, for those exempted securities dealers, and their affiliates, covered by the Order. A Canadian wrapper has been used to satisfy three Canada-specific disclosure requirements that arise out of securities legislation in one or more provinces: 1) disclosure about whether an issuer or selling securityholder is either a "connected issuer" or "related issuer" of an underwriter (this disclosure is similar to "conflicts of interest" disclosure in the United States); 2) a description of the statutory rights of action available to investors in specific provinces if the offering document contains a misrepresentation; and 3) notification to investors and authorization to collect personal information of the purchasers to provide to regulators in certain provinces, including Ontario.

Relief from Preparing

The relief granted by the Order will permit sellers of securities to use an offering document that does not contain the disclosure relating to statutory rights of action. In addition, the Order grants relief from the requirement to disclose the status of an issuer as a related or connected issuer to an underwriter. The relief from providing related or connected issuer disclosure, however, is conditioned on the offering document complying with US securities laws and regulations regarding underwriting conflicts of interest disclosure as required by FINRA and the SEC. However, the offering itself does not need to be registered under US law; rather, the US or other foreign private placement circular would be acceptable as long as its disclosure of underwriting conflicts of interest meets the same standard as for a US registered offering. Furthermore, pursuant to a separate letter released by the director of the OSC, the OSC acknowledged that notification of collection of investors' personal information applies only to investors who are individuals and not to corporations or other institutions, effectively removing the need for this disclosure in those instances where securities are sold to institutions.

The relief granted pursuant to the Order is subject to several conditions: 1) the offering must be primarily made outside Canada; 2) the issuer must be a foreign issuer that does not have its head office or principal office in Canada and it may not be a Canadian reporting company; 3) Canadian purchasers are limited to only "permitted clients"[7] as defined under Canadian securities law; 4) prior to the exempted dealer's first reliance on the Order, the dealer must deliver the form of notice, as prescribed in the Order, to prospective purchasers and receive signed acknowledgement and consent from the purchaser regarding the dealer's reliance on the exemption provided by the Order[8]; and 5) on a monthly basis the exempted dealer must deliver to its principal regulator, in Canada, information with respect to the exempt distributions made in reliance on the Order.

Amendment to Disclosure Rule

In addition to the relief granted pursuant to the Order, the OSC commenced rule making that would amend the *Ontario Prospectus and Registration Exemptions* for offerings of "designated foreign securities."[9] The effect of this rulemaking would be to codify most of the changes introduced in the Order. In addition, the OSC and other members of the Canadian Securities Administrators have started the process of considering amendments to the underwriting conflicts of interest disclosure requirements to provide relief where offerings by foreign issuers provide comparable alternative disclosure. While Ontario is leading the effort to amend its disclosure requirements, other provinces, including Nova Scotia, New Brunswick and Saskatchewan, have also proposed similar rule changes.

Timing and Effect

The exemption became effective on June 22, 2013. The exemption permitted by the Order is slated to expire in June 2016, but it is anticipated by that time the exemption will be permanently enacted through formal rulemaking at each provincial securities regulator. There will remain a significant number of circumstances where private placements by foreign issuers may still face Canadian regulatory hurdles and may require the preparation of a Canadian wrapper.[10] But in many circumstances, as described above, the good news is the Canadian wrapper itself will no longer be necessary.

Note: The foregoing is not intended as advice on Canadian law, and if an offering is made to Canadian offerees, Canadian counsel must be consulted on these and other issues.

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[5] Available at: http://www.osc.gov.on.ca/en/SecuritiesLaw_ord_20130425_216_barclays-capital.htm

[6] As of the date of this article, if the appropriate conditions are met, the following dealers may sell securities in Canada without preparing a Canadian wrapper: Barclays Capital Inc.; Citigroup Global Markets Inc.; Deutsche Bank Securities Inc.; HSBC Securities (USA) Inc.; J.P. Morgan Securities LLC; Merrill Lynch, Pierce, Fenner & Smith Incorporated; RBC Capital Markets, LLC; Scotia Capital (USA) Inc.; and UBS Securities LLC.

[7] A "permitted client" is similar to a QIB as defined in Rule 144A under the Securities Act of 1933, as amended.

[8] This is a one-time-only requirement.

[9] Proposed amendments are available at: http://www.osc.gov.on.ca/en/SecuritiesLaw_rule_20130425_45-501_rfc-pro-amend.htm

[10] In particular, issuers that are investment funds, limited partnerships or banking or financial institutions should consult with Canadian counsel, as other Canadian regulatory requirements may still apply.

Too Late to the Party?: The 144A Reopening Post A/B Exchange

Attorneys at Hunton and Williams LLP recently represented the initial purchasers in an offering structured as a reopening of an existing series of debt maturing in 2041. The original offering was completed in November 2011 and was sold only to “qualified institutional buyers” under Rule 144A and to non-US persons outside the United States in accordance with Regulation S. However, both the notes originally sold pursuant to Rule 144A and those sold to non-US persons were subsequently exchanged for identical registered notes in August 2012.

The question arose whether it was possible to reopen a series in a private transaction where the original issuance had already been registered through an Exxon Capital A/B exchange offer. An Exxon Capital exchange offering is a procedure under which securities are privately placed pursuant to Rule 144A and then promptly exchanged for similar securities that have been registered under the Securities Act. The SEC staff’s positions in this area come from a series of no-action letters: Exxon Capital Holding Corp. (available May 13, 1988); Morgan Stanley & Co. Incorporated (available June 5, 1991); K-III Communications Corporation (available May 14, 1993); and Shearman & Sterling (available July 2, 1993).

The initial question was whether the documents that established the series of notes in 2011 allowed for a reopening. Once this was confirmed, it was necessary to also determine that the add-on offering of notes would be fungible with the original tranche for US federal income tax purposes. (*See* the Baseload article from June 2012 for the related tax discussion: “Recent Financing Trend: Reopening Previous Issues of Debt Securities.”) In this case, “practical” fungibility for tax purposes was established as both offerings were sold with less than a de minimis amount of original issue discount. The reopening was, in fact, sold at a premium, rather than a discount. Having cleared these two hurdles, nothing prevented the 144A reopening from ultimately (after the registered exchange) being fungible for all purposes with the existing registered notes.

One question is whether, in such a case, the issuer should establish a new 144A CUSIP and Regulation S CUSIP for the second offering. The concern is that adding the reopening securities to an existing private CUSIP could obfuscate the holding periods of any existing holders under Rule 144. In this particular case, none of the original issuance was still held in the 144A or Regulation S CUSIP, thereby rendering the issue moot. A related suggestion, however, is to involve the trustee for the series of notes, and the trustee’s counsel, early in the offering process. The working group should have a clear vision of how the reopening will be mechanically structured and, post-exchange, what procedures the trustee will take in order to add the reopened debt to the existing registered CUSIP. Another consideration is an integration of the public offering, the A/B exchange, with the subsequent private offering of the same series. In this case, these two events were in excess of six months apart and therefore not at risk of integration. If the timing had been different, additional consideration would need to be given to the possibility of integrated offerings.

Although this scenario arises infrequently, after jumping through the appropriate hoops, little should prevent an issuer from effecting a 144A reopening after the original issuance has been exchanged for registered securities.

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